

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC: [REDACTED]:TL-N-6781-98 advice.01.wpd  
[REDACTED]

date: April 19, 1999

to: District Director, [REDACTED]  
Attn: [REDACTED] Case Manager [REDACTED]  
Attn: [REDACTED] Revenue Agent [REDACTED]

from: District Counsel, [REDACTED]

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subject: Employment Tax Information Returns

Taxpayer: [REDACTED]

EIN: [REDACTED]

You have asked for advice on the taxpayer's responsibility for filing information returns in connection with certain transactions with its dealers.

**I. Issue**

How and when should [REDACTED] report amounts of cash or the value of property conveyed to its dealers in connection with "cash contributions" or the sale of service stations to the dealers?

**II. Conclusion**

Cash advances or reimbursements made to dealers in connection with the cash contribution or "image upgrade" program are income to the dealer when received, and therefore [REDACTED] should report them at , and the value measured by the "notes" used in the sale of service station transactions all give rise to reportable income when paid.. However, "forgiveness of indebtedness" amounts should not be reported..

**III. Facts**

[REDACTED] has agreements with its dealers under which, broadly speaking, it advances or reimburses sums to be expended for improvements to the stations, or gives a cents-per-gallon discount on purchases of gasoline if certain improvements are made.

When advances or reimbursements are made, they are usually made to the individual who owns the station, whether the station is owned directly or through a corporation. The transactions are structured as loans from [REDACTED] and regarded by [REDACTED] as being paid over time by being "forgiven" based on the volume of gasoline purchased. The owners are credited with a cent-per-gallon discount for a state period of time.

[REDACTED] does not issue 1099s reflecting the advances or reimbursements. It does, however, issue 1099s when the owners are credited with the discounts for volume purchases of gasoline, although it has not done this until recently and for some of the years in issue, no 1099s were issued at all.

There are three scenarios which you initially wished us to address in advising you whether [REDACTED] should be filing information returns: Image Upgrade payments, Jobber Incentive payments, and sales of service stations. However, you have advised us that the Jobber Incentive payments were all made to corporations, and therefore not subject to the reporting requirements.

#### **Image Upgrade Payments (Cash Contributions)**

[REDACTED] maintains a program in which it advances to dealers amounts (referred to by [REDACTED] as "Real Estate Contributions") which are intended to help defray certain outlays, typically for improving and upgrading facilities, equipment, and /or signage at retail locations. Repayment of the funds is contingent upon the dealer continuing its affiliation with [REDACTED] and its sale of [REDACTED] brand gasolines. If the affiliation continues, [REDACTED] agrees to reduce the amount owed to it by either crediting the loan balance monthly with a fixed dollar amount (usually based on the length of the contract) or by an agreed upon cents per gallon throughput (sales). The reduction is treated as "Loans Forgiven." Terms of the agreements are secured through the execution of a contract known as a "Dealer Supply Agreement."

[REDACTED] issues Forms 1099 at the end of each year reflecting the amount of the note reduction in each year. We do not know if this amount includes an amounts of interest which has accumulated.

#### **Sale of Service Stations**

[REDACTED] agrees to sell service stations to specific dealers, and the sales are financed in whole or in part by [REDACTED]. The buyer gives a note to [REDACTED] for a portion of the purchase price. The sales prices of the stations are at arms length, and there is no evidence that bargain sales are involved, although initially you believed that there might be.

The notes provide for a fixed maturity date but no schedule for repayment except via crediting the amount due on the notes (plus interest) based on how much gasoline is bought during the period covered by the notes. There is no indication that any security was given for the notes. Interest is stated, at what appear to have been prevailing rates. [REDACTED]'s records label the transactions as loans, but despite the terms of the note providing how interest is being paid, [REDACTED] did not taken any interest into income during [REDACTED] or [REDACTED].

#### **IV. Discussion**

Under IRC § 6041, payments taxable to the recipients must be reported by the payor on information returns setting forth the amounts of the payments. These returns are made on Forms 1096 and 1099.

The question is which of the amounts being advanced, reimburse or credited by [REDACTED] are taxable to the recipients, and hence subject to the reporting requirements.

[REDACTED] contends that the payments involved were loans, and the paper transactions are couched in terms which make it appear that loans were involved. However, we believe that the economic reality of the transactions is not what [REDACTED] contends.

### Image Upgrade Payments (Cash Contributions)

A loan exists for federal income tax purposes only if a bona fide debtor-creditor relationship arises upon transfer of the funds, such that the recipient becomes unconditionally obligated to repay the funds to the payor. *Fisher v. Commissioner*, 54 T.C. 905 (1970). Whether such an obligation arises is a question of fact.

PLR 9719005 summarizes the tests and criteria by which this factual determination is made::

A loan exists for federal tax purposes only if a bona fide debtor-creditor relationship arises upon the transfer of the funds, such that the recipient becomes unconditionally obligated to repay the funds to the payor. *Fisher v. Commissioner*, 54 T.C. 905 (1970). Whether such an obligation arises is a question of fact. *Gooch Lumber Sales Co. v. Commissioner*, 49 T.C. 649 (1968).

An essential element for the existence of a debtor-creditor relationship is whether the party receiving the proceeds intended to repay the other party and whether the other party intended to enforce the obligation. *Beaver v. Commissioner*, 55 T.C. 85 (1970); *Friedrich v. Commissioner*, T.C. Memo 1989-103. In attempting to discern the intent of the parties, courts have examined various factors such as whether notes or other evidence of indebtedness exist (*United States v. Uneco Inc.*, 532 F.2d 1204 (8th Cir. 1976); *Security Associates Agency Insurance Corp. v. Commissioner*, T.C. Memo 1987-317); whether interest is charged (*Rolwing-Moxley Co. v. United States*, 589 F.2d 353 (8th Cir. 1979); *Colombo v. Commissioner*, T.C. Memo 1975-162); whether there is a fixed maturity date or schedule for repayment (*In re Indian Lakes Estates, Inc.*, 448 F.2d 574 (5th Cir. 1971)); whether any security is requested (*United States v. Henderson*, 375 F.2d 36 (5th Cir. 1967)); and whether the parties' records reflect the transaction as a loan (*Georgia Pacific Corp. v. Commissioner*, 63 T.C. 790 (1975)). In addition, in determining whether a transaction created a true debtor-creditor relationship, courts have looked to the underlying economic substance of the agreement rather than the parties' characterization of the transaction. *Hardman v. United States*, 827 F.2d 1409 (9th Cir. 1987).

In this case, the notes relating to the Cash Contributions fall short of creating a debtor/creditor relationship in several obvious ways. There is no interest to be paid, and no payments to be made. Further, it is clear that the intent of the parties is that the "loan" never be repaid. Instead, the parties intend that it be forgiven. As you point out, the situation is very similar to those in *Colombo v. Commissioner*, T.C. Memo 1975-162 and PLR 9308001, which reach the same conclusion.

The economic substance of the transactions is that [REDACTED] agrees to pay the dealers to continue to purchasing [REDACTED] products for a definite time period. The purported loans are merely contracts laying out the terms under which the payments are being made, and what happens if the dealers do not perform. As such, the proper treatment of the Cash Contribution is as income to the dealer when paid. Therefore, 1099s should be issued when the amounts are paid over to the dealers, not when [REDACTED] "forgives" the purported debt created.

### Sale of Service Stations

Applying the criteria outlined above, it appears to us that the economic substance is that these are not *bona fide* debts. Rather, they appear to be in the nature of incentive arrangements, and the reality is that if the buyer does not purchase the requisite amount of gasoline, only then does the "note" become due. Consequently, the amount of the notes should be treated as payments which should have been reported on forms 1099.

CC: [REDACTED] TL-6781-98

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This advice was informally coordinated with William Heard in Field Service. It is subject to post-review, which should normally be finished in the next two weeks. If the National Office recommends any material change or addition to this advice, we will advise you immediately.

[REDACTED]  
District Counsel

By [REDACTED]

Special Litigation Assistant

cc: Assistant Chief Counsel (Field Service) CC:DOM:FS  
Assistant Regional Counsel (Tax Litigation) CC: [REDACTED]  
[REDACTED]